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STATE FOR NEA/ARP, EB; TREASURY FOR SAEED, KAPROTH

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TAGS: EFIN ECON PREL KU
SUBJECT: TREASURY DAS SAEED DISCUSSES SOVEREIGN WEALTH
FUNDS WITH GOK

REF: KUWAIT 1308

Classified By: Acting DCM Tim Lenderking for reasons 1.4 (b) and (d)

¶1. (C) Summary: On September 17, a U.S. Treasury delegation led by Middle East DAS Ahmed Saeed and International Monetary Policy Director Robert Kaproth met with the Kuwait Investment Authority (KIA), the Central Bank of Kuwait (CBK), the Finance Ministry, and the Public Institution for Social Security (PIFSS) to encourage continued Kuwaiti investment in the U.S. and to promote the development of best practices for the management of Sovereign Wealth Funds (SWFs). Saeed and Kaproth referred to Treasury Assistant Secretary Clay Lowery's June 21 speech at the San Francisco Fed, in which he suggested that SWFs could collaboratively develop a set of best practices for governance, risk management, accountability, and transparency through the IMF. Saeed and Kaproth argued that this could serve to help new SWFs to develop sound strategies and practices, reduce systemic risk, and lower the risk of a protectionist backlash against SWF investment. Overall, the Kuwaitis' reception to Treasury's message was positive to the extent that they are willing to engage in further dialogue on the subject, but we will still need to overcome some skepticism, especially on the part of the Managing Director of KIA. The Kuwaitis recognize some potential benefits for Kuwait but need some time to consider the proposal before making any commitment. Although it seems unlikely that the GOK will take a lead role in bringing other SWFs onboard, the Kuwaitis may be willing to sign on as an early follower. End Summary.

Why so much sudden interest in SWFs?

¶2. (SBU) On September 17, a U.S. Treasury delegation led by Middle East DAS Ahmed Saeed and International Monetary Policy Director Robert Kaproth met with the Kuwait Investment Authority (KIA), the Central Bank of Kuwait (CBK), the Finance Ministry, and the Public Institution for Social Security (PIFSS) to encourage continued Kuwaiti investment in the U.S. and to promote the development of best practices for the management of Sovereign Wealth Funds (SWFs). Saeed emphasized that the U.S. remains open to foreign investment, pointing to the President's May 10 statement on open investment and trade, the passage of the Foreign Investment and National Security Act of 2007, and G7 official communiqus endorsing open investment. Saeed noted, however, that SWFs were coming under increasing scrutiny and possibly contributing to protectionist fears in the OECD countries, as evidenced by recent reporting in the financial and popular press. He said he saw three reasons why these funds, some of which have existed for over thirty years, were suddenly attracting so much attention. First, the assets under management of SWFs have grown from tens of billions of

dollars into trillions of dollars. Second, a number of new SWFs have emerged in recent years, approximately 17 since ¶2000. Third, the lack of transparency in some of these funds leads to fears that they could be used to pursue political or strategic objectives rather than purely financial ones.

Proposal to develop SWF Best Practices

¶3. (SBU) Kaproth referred to Treasury Assistant Secretary Clay Lowery's June 21 speech at the San Francisco Fed, in which Lowery suggested that SWFs could develop collaboratively with the IMF and World Bank a set of best practices for governance, risk management, accountability, and transparency through the IMF. Kaproth provided copies of an analogous set of best practices developed by the IMF for the management of foreign reserves. Kaproth stressed that the U.S. was not trying to tell SWFs how to manage asset allocation or even asking for full disclosure of specific investments but rather promoting the development of a non-binding set of common principles for governance and risk management to which SWFs could voluntarily subscribe. Saeed added that a public commitment to adhere to these best practices could serve as a "Good Housekeeping Seal of Approval" to differentiate high-quality, responsibly managed funds, from riskier or more politically-motivated funds. Kaproth said a set of SWF best practices could serve three important purposes. First, it would help newly-established SWFs to establish sound strategies and practices. Second, it could help reduce systemic risk. Third, it could help to lower the risk of a protectionist backlash against SWF investment.

¶4. (SBU) Saeed pointed out that a range of SWFs with very different profiles were currently being lumped into a single category. He suggested that by endorsing a set of commonly approved best practices, investors such as the Kuwait Investment Authority, which has been a responsible and mostly passive investor in the U.S. since 1953, could differentiate themselves from less desirable investors. Kaproth noted that SWFs demonstrate many reassuring features: they tend to be long-term investors who can weather short-term losses, they are not highly leveraged, and they cannot be forced by capital requirements or investor withdrawals to liquidate positions rapidly. He added, however, that SWFs possess some unattractive characteristics as well. First, their lack of transparency means that rumors or suspicions of their actions can move markets. Second, SWFs typically lack the system of informal checks and balances that investors, creditors, and counterparties exert over other funds.

KIA somewhat skeptical; willing to consider

¶5. (C) KIA Managing Director Bader Al-Saad reacted by saying, "What's the worry? Is it just the size? What about private equity?" He added that after the problems with Dubai Ports World and the sanctions imposed on Iran, "We as investors should be more worried than you as investees." Al-Saad pointed out that KIA already has a system of checks and balances since the State Audit Bureau, the Parliament, and the Government all review its decisions. He added, "Politicians will be politicians" regardless of whether foreign investors have signed on to a set of best practices. Al-Saad noted that the controversy over CNOOC's bid for Unocal had nothing to do with SWFs. He admitted that recent media reports had been worrisome but said, "The ball's in your court" to educate the public about the advantages of foreign investment. Saeed responded that the USG recognizes that it too has a responsibility, which is why it hopes to work collaboratively with SWFs to reduce the risk of protectionism. Kaproth added that the USG was recommending

that a parallel set of best practices be developed for recipient countries of SWF investment within the OECD. In the end, Al-Saad said he would think about the proposal to collaborate with other SWFs on best practices, but he was not convinced it would provide any benefit for Kuwait. For more background on KIA, see reftel.

Central Bank supports further dialogue

¶6. (C) Central Bank Governor Shaykh Salem Al-Sabah said he had been hearing rumblings about an SWF best practices proposal since the spring IMF meetings, but he was initially unclear on what was being asked for. After hearing Saeed and Kaproth's explanation, he said he understood the objectives and hoped to engage in further dialogue on the subject.

Finance U/S will recommend to Minister

¶7. (C) Under Secretary of Finance Khalifa Hamadah said the KIA board, which includes, among others, the Minister of Finance, the Central Bank Governor, and the Oil Minister, would ultimately decide on whether to participate in the collaborative development of SWF best practices. He added that there may be legal constraints that limit the information the KIA can disclose. Hamadah said the proposal was a "good idea in principle" and he would recommend to the Finance Minister that he support it within the limits set by Kuwaiti law. Al-Hamadah asked if these efforts had anything to do with concerns over money laundering. Kaproth clarified that although Treasury had an active campaign underway to combat money laundering, this effort was not related. He added that it also had nothing to do with reducing yields on U.S. treasuries.

Pension Fund: KIA should be able to support

¶8. (C) PIFSS Director General Fahed Al-Rajaan said, "America is still the best place to invest," and "the Gulf is still pro-American." He said that even when he invests in emerging markets, he prefers to do so indirectly through U.S. funds. Al-Rajaan insisted that the GCC funds were passive investors, not politically-motivated, and interested only in financial returns. Al-Rajaan added that KIA should have no problems

with showing greater transparency since it already practices good governance.

Comment

¶9. (C) Overall the Kuwaiti reception to Treasury's message seemed positive to the extent that they are willing to engage in further dialogue on the subject. KIA Managing Director Al-Bader seemed very resistant at the beginning of the meeting, but at the end he indicated he would give the proposal further consideration. The Central Bank Governor and PIFSS DG both recognized some benefits in the proposal and welcomed further dialogue. The Under Secretary of Finance was most supportive, but ultimately the Finance Minister will likely be the key decision maker on this issue, and he was out of the country during the visit. Post will re-engage in the next two to three weeks once the GOK has had an opportunity to digest the concept. A personal pitch to the Finance Minister would clearly be beneficial. Ultimately, the GOK is not openly embracing this approach, but it is not rejecting it either. Although it seems unlikely that the GOK will take a lead role in bringing other SWFs onboard, the Kuwaitis may be willing to sign on as an

early follower.

¶10. (U) Saeed and Kaproth were accompanied to their meetings by Treasury Attach to Abu Dhabi Matt Epstein, Treasury Economist Matthew Turner, Econcouns, and Econoff. DAS Saeed cleared this message.

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